LEHMAN BROTHERS HOLDINGS, INC.

REPORT ON LIQUIDITY & FUNDING RISK MANAGEMENT

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LEHMAN BROTHERS HOLDINGS, INC.
LIQUIDITY AND FUNDING RISK MANAGEMENT

I. EXECUTIVE SUMMARY

LEHMAN BROTHERS HOLDINGS, INC., ("Lehman Brothers" or the "firm") has submitted an application to become a Consolidated Supervised Entity ("CSE") subject to the requirements set forth in Rule 15c3-1 (and related appendices thereto) under the Securities Exchange Act of 1934.

Staff from the Division of Market Regulation reviewed Lehman Brothers' liquidity and funding risk management primarily to evaluate the firm's policies and ability to assure adequate liquidity and funding at all times, including periods of significant market fluctuations and financial stress. Discussions and planning of the work began in March 2005 with management of the Lehman Brothers Global Treasury function. The majority of the field work was conducted at the firm in May and June 2005. Follow-up questions were addressed by telephone and email. The staff's report was drafted during June and July 2005.

The scope of the review included the funding framework, governance structure, organization structure, lines of authority, policies and procedures, internal management reports, and various other documents and models including the liquidity and funding models and the liquidity crisis plan. Treasury's policies, procedures, and controls with regard to liquidity, sources of funding, and management of the balance sheet including capital, leverage, and asset and debt levels were also considered. The Corporate Audit staff, the firm's internal auditors, was also consulted.

The review of the liquidity and funding risk management functions of Lehman Brothers found no material deficiencies. There are some enhancements that have been discussed with the firm, described under "Planned Enhancements". As of this date, these enhancements are works in process and will be reviewed with the firm by the staff as part of the ongoing supervisory program.

Lehman Brothers currently has adequate liquidity and sufficient capital to fund its current business in the staff's opinion.

Overall, with respect to liquidity and funding risk management, Lehman Brothers has an adequate liquidity and funding risk management to become a CSE, and accordingly, it is recommended that the application by Lehman Brothers to become a CSE, as it pertains to the liquidity and funding risk management function, be approved.

II. REVIEW PURPOSE AND SCOPE

The primary purpose of the SEC's review of Lehman Brothers' liquidity and funding risk management was to evaluate the firm's policies and ability to assure adequate liquidity and funding at all times, including periods of significant market events and financial stress. Most failures of financial institutions have occurred in large part due to a lack of adequate liquidity, which has amplified the impact of other events. The review evaluated the adequacy of current policies, procedures and controls with respect to their effectiveness in managing liquidity and funding risk on a global, consolidated basis. The staff, in developing its review process, identified certain core elements of an effective liquidity and funding risk management framework to be considered as part of the application review. These elements are summarized below.

Governance structure

A well-defined and documented governance structure for the management of liquidity and funding risk should exist. This would include the organizational structure and established oversight executive committees with clearly delineated mandates covering their membership, responsibilities, lines of reporting, and frequency of meetings. A global treasury function to manage the liquidity and funding processes should exist under independent oversight of appropriate committees, such as the Finance Committee.

Liquidity and funding management policies and procedures

Detailed and documented liquidity and funding policies and procedures established by global treasury and approved by independent oversight committee(s) should exist. The firm's policies and objectives should be clearly delineated and accompanied by appropriate procedures. All significant liquidity and funding risk management areas of responsibility of the global treasury function should be described.

Management internal reporting system

Global treasury should have a formal management reporting system that conveys to senior management and oversight committees on a regular basis the relevant qualitative and quantitative information needed to make informed liquidity and funding decisions, as well as related risk management and business decisions. The content of the reporting package may vary by firm, but should include relevant information regarding funding sources and uses, liquidity and leverage ratios, limits and excession reporting, liquidity portfolio, credit facilities, collateral and unencumbered collateral, new issuances and term structure of debt.

Stable and diverse funding sources

Each firm should have established stable and diverse sources of funding to limit dependencies on any one investor group or region. The focus should be to continually expand and globally diversify the firm's funding programs and activities across debt markets, and investor and creditor base to minimize dependence on any one investor group or region. Diversification may be achieved through the use of limits, for example, a limit on the amount of debt concentrated with a single investor.

Borrowing capacity of unencumbered assets

The firm should continually monitor the borrowing capacity of its portfolio of unencumbered assets and related liquidity ratio (ratio of borrowing capacity to amounts due within one year) and establish a target minimum ratio.

Less liquid and illiquid assets

Policies and procedures for identifying, monitoring, and managing less liquid and illiquid assets should be in place. Less liquid assets should be funded by long term debt or equity to the extent that they cannot be funded on a secured basis and illiquid assets should generally be funded with long term debt or equity. Less liquid assets are frequently referred to as "hard to fund" assets at Lehman Bothers.

Limits

A formal limit setting and monitoring process should be established and documented by the global treasury function and be approved by the appropriate oversight management committees. Limits on balance sheet assets and limits by borrowing type and maturity should be established. A formal system of limit excession reporting and resolution should be established.

Liquidity Portfolio

Each firm should maintain cash and/or a liquidity portfolio of segregated and unencumbered securities consisting of highly liquid and highly rated securities, such as U.S Government and agency obligations, and asset-backed securities. These assets may be sold or pledged to provide immediate liquidity to repay maturing debt, satisfy collateral calls or meet other obligations. The ability to hypothecate these securities without market impact should be tested regularly.

Committed credit facilities

Firms should maintain an appropriate mix of unsecured and secured committed credit facilities in order to have sources of committed funding in place should a liquidity funding stress event occur. Committed secured credit facilities to fund various assets classes, including less liquid assets, with reliable banks and other counterparties are increasingly common. Committed secured credit facilities are regularly drawn and repaid in the normal course of funding secured financing transactions. The unsecured and secured committed credit facilities continue to be an area of focus for credit rating agencies. Although firms are aware of the possible signaling effect of draws under the unsecured facilities, many firms have attempted to mitigate the signaling by negotiating with the banks that the facilities will be regularly drawn and repaid. In some instances however, committed unsecured facilities may only be drawn upon in extreme liquidity events, and doing so may result in signaling a liquidity issue and significant reputational damage to the firm.

Liquidity crisis plan

Each firm should maintain a documented and approved (by independent oversight committee(s)) contingency funding plan which sets out a detailed plan of action to manage a liquidity stress event within the firm. The goal of the contingency funding plan is to manage liquidity risk and communicate effectively with creditors, investors and customers during a funding crisis or market stress event.

Stress testing

Liquidity and funding stress testing should be performed on a periodic basis, with results reported to senior management. While such stress testing should satisfy the requirements of Rule 15c3-1g(c), which stipulates at least once a quarter, it is the position of the staff that prudent risk management would require stress testing on a more frequent basis. The assumptions and methodologies of the stress testing should be clearly defined and documented.

Internal audit

The Corporate Audit review should include all significant elements of the global treasury function in its risk-based audit program.

To evaluate Lehman Brothers' liquidity management process against these benchmarks, interviews were conducted with senior management, liquidity and funding risk management policies and procedures were reviewed, and management reports were analyzed and discussed with management. Various other documents and reports, including findings from the latest corporate audit reports, were reviewed. The SEC staff also had discussions with the Corporate Audit concerning their coverage of Treasury and related functions. The SEC staff reviewed documented policies and procedures. Additional information and content was obtained from the application, discussions, and presentations to the staff.

III. LIQUIDITY AND FUNDING RISK MANAGEMENT

ADEQUACY OF LIQUIDITY

Lehman Brothers currently has adequate liquidity and sufficient capital to fund its current business.

Lehman Brothers appears prepared to face both a market liquidity event, some broad disruption to the marketplace leading to a global liquidity squeeze, and a Lehman specific liquidity event. The firm has been through a number of stress events, including the 1998 market event and September 11, 2001. Management believes that the lessons from such experiences have been incorporated into the firm's current liquidity and funding process.

Lehman Brothers funding strategy seeks to ensure that the firm maintains sufficient liquid financial resources to continually fund its balance sheet and to meet all of its funding obligations in all market environments based upon the following principles:

- The firm must remain in a constant state of liquidity readiness, as liquidity providers are credit and market sensitive and quick to react to any perceived market or firm-specific risks. This requires maintaining a large cash position and/or liquidity pool in the holding company chain sufficient to absorb the impact of a very severe liquidity event.

- Reliance is placed on secured funding only to the extent that the firm believes it would be available in all market circumstances, including a stress event. This requires establishing reliable secured funding levels by asset category by counterparty. During a liquidity stress event, certain lenders will require higher quality collateral, resulting in lower availability of secured funding for less liquid or hard to fund asset classes.

- The firm does not assume that, in a liquidity crisis, assets can be sold to generate cash, unsecured debt can be issued or any cash and unencumbered liquid collateral outside of the liquidity pool can be used to support the liquidity of the holding company or its unrestricted subsidiaries. The plan is not to be forced to reduce the balance sheet for liquidity reasons in a liquidity event (although it may be reduced for risk reasons).

- Since the legal entity structure may constrain the movement of liquid assets, the firm must ensure that there is sufficient stand alone liquidity in each of (1) the holding company and its unrestricted subsidiaries and (2) the restricted or regulated subsidiaries. The firm treats all excess cash in restricted or regulated entities as "trapped".

When managing liquidity, Lehman Brothers pays particularly close attention to the following, which are referred to as the Four Pillars of the Funding Framework.

- Liquidity Pool - sized to cover all expected cash outflows for one year in a liquidity stress event
- Cash Capital – sufficient given long-term funding sources and requirements
- Reliable Secured Funding Capacity – relied upon only to the extent that the secured funding is reliable in all market environments, which is measured by The Reliable Secured Funding Model that seeks to conservatively assess reliable secured funding by asset class.
- Contingency Funding Plan

A more detailed discussion of each of the Four Pillars of the Funding Framework is contained on the following pages.

LIQUIDITY POOL

The Firm's policy is to maintain a liquidity pool for the holding company and its unrestricted subsidiaries that would cover all expected cash outflows for one year in a stressed liquidity environment. The liquidity pool is intended to cover the roll-off of unsecured debt for one year, fund additional requirements during liquidity events such as additional collateralization of derivatives and the drawing down of unfunded commitments, and to fund the buyback of equity and debt if the firm chooses to do so. The liquidity pool totaled $18.7 billion at the fiscal year ended November 30, 2004 and $18.8 billion at the end of February 2005. The liquidity pool as viewed by Lehman Brothers includes the undrawn portion of the holding company's $1.5 billion committed working capital credit facility. While the firm clearly believes that the funds from this facility would be readily available in a stress event, the SEC staff's view is that such facilities are distinct from cash and unencumbered liquid securities that can be readily hypothecated and thus should not be considered as a part of the liquidity pool. The amount of the liquidity pool, without considering the $1.5 billion committed credit facility, would be $17.2 billion at the year end November 30, 2004 and $17.3 billion at the end of February 2005.

The liquidity pool is invested in cash and unencumbered, investment grade liquid collateral that can be monetized at short notice in all market environments to provide liquidity to the holding company, which issues most of the unsecured debt. The cash raised by financing the collateral in the liquidity pool can be upstreamed to the holding company in all market environments, if it is not already at the holding company. For example, in the case of unencumbered collateral owned by Lehman Brothers Inc., the U.S. broker dealer, Treasury reverses this collateral into the holding company through a triparty repo agreement. The pool includes Treasuries, G7 Governments, Agencies, investment grade asset-backed and corporate fixed income securities, S&P 500 equities and other large, liquid stocks with sizeable secured funding markets. The firm requires that there be a deep, liquid and reliable funding market for this collateral in all market environments. The majority of the investments are done on an overnight basis. The liquidity pool is actively managed by Treasury.

The liquidity pool value of $18.8 billion at the end of February 2005 was comprised of cash of $2.1 billion, investment grade securities with an estimated pledge value of $15.2 billion and the undrawn portion of the holding company committed credit facility of $1.5 billion. The $15.2 billion of investment grade securities include U.S. Treasuries and G-7 government securities of $7.4 billion, FHLB eligible residential mortgages of $3.3 billion, repoable preferred shares of $2 billion with Lloyds TSB (AA rated) and $400 million with National Australia Bank (AA rated) both of which include put options whereby funds would be received within five days, and private label investment grade CMOs in the amount of $1.4 billion. As stated above, the liquidity pool value without considering the committed credit facility was $17.2 billion and $17.3 billion at November 30, 2004 and February 28, 2005 respectively.

The size requirement for the liquidity pool is reassessed weekly based upon expected cash outflows for one year in a stressed environment. The weekly reassessment of the size of the liquidity pool is performed by the Management Finance Committee. The expected cash outflows are measured using the Maximum Cumulative Outflow (MCO) model. The MCO calculates expected cash outflows in a stressed environment by including outflows for items such as the repayment of all unsecured debt of the holding company and its unrestricted subsidiaries maturing within twelve months, the drawdown of commitments to extend credit based on an analysis of the probability of such drawdowns, the widening of haircuts due to stressed market conditions, additional collateralization of derivative contracts that would be required following a credit ratings downgrade, funding of debt and equity repurchases, and the outflow of short term or "hot" money to customers like hedge funds. The actual amount of the liquidity pool always includes a surplus in excess of the MCO size requirement. The target amount of the surplus is at least $2 billion although the surplus has been consistently higher than that in recent months. For example, the surplus was $7.1 billion at the year ended November 30, 2004; $5.3 billion at the quarter ended February 28, 2005; and $3.8 billion at the quarter ended May 31, 2005.

The liquidity pool at the holding company is distinct from cash and unencumbered liquid assets held in the broker dealers, Lehman Brothers Bank and Lehman Brothers Bankhaus, which are referred to as restricted or regulated subsidiaries. This additional liquidity in the restricted or regulated subsidiaries is provided by unencumbered assets as a result of their business activities. However, the parent's ability to access these funds may be restricted by legal and regulatory requirements including capital requirements applicable to regulated subsidiaries including the banks and broker-dealers. At the end of February 2005, the estimated pledge value of these unencumbered assets totaled $39.6 billion, of which $37.7 billion was held by restricted or regulated subsidiaries. While these additional unencumbered assets could in theory be pledged to raise liquidity to the extent that they are liquid, the firm does not rely on them in their liquidity planning. The firm believes this is a conservative and prudent approach to liquidity management.

The $1.5 billion committed, multi-currency, unsecured bank credit facility is a source of liquidity for the holding company. Lehman Brothers considers the facility as a part of the liquidity pool. Although the SEC staff does not consider the facility as a part of the liquidity pool, the staff does recognize that it is a source of funding that may appropriately be considered in overall liquidity planning. In the view of the staff, the committed credit facility is distinct from and does not have the same liquidity as cash and unencumbered securities in the liquidity pool. The staff does recognize that this committed credit facility is a working capital facility that is regularly drawn upon in the normal course of business and is fully drawn from time to time. The firm believes that this eliminates the signaling effects of drawing on the facility, and differentiates it from some other firms where the credit facility is a back stop facility and is not drawn or seldom drawn in full. The facility is described later in this report.

CASH CAPITAL

Cash capital, which Lehman Brothers rather uniquely defines as including stockholder's equity and long-term debt, excluding the current portion, plus the undrawn portion of unsecured committed facilities and other long-term secured obligations with remaining terms greater than one year, is used to measure long-term funding sources and requirements. Core deposit liabilities at the Lehman Brothers banks are an additional source of cash capital for these regulated entities. What makes the Lehman Brothers approach different from that used by many other firms is that committed unsecured and secured facilities with remaining terms of over one year are included as a source of cash capital at the holding company. Lehman Brother's general policy is to operate with an excess of long-term funding sources over long-term funding requirements of at least $2 billion at the holding company. Most of the time, the cash capital surplus is significantly in excess of the $2 billion target. At both February 28, 2005 and November 30, 2004, the firm had $10 billion of cash capital surplus across all legal entities with $6 billion and $7 billion respectively available at the holding company and its unrestricted subsidiaries.

Long term debt with a remaining term greater than one year is the largest source of cash capital for the firm. Of the cash capital sources totaling $79 billion at the year ended November 30, 2004, about 62% or $49 billion came from long term debt. The major challenge in managing long term debt is to minimize the refinancing risk by spreading the maturities of the long term debt. The firm sets limits for the amount of outstanding long term debt maturing for three, six and twelve month time horizons. These limits are set by Treasury and the syndicate desk based on what is believed to be a conservative assessment of the market's short term appetite for Lehman's debt. Additionally, the debt holder base is diversified by issuing across different markets, i.e. U.S., U.K., Continental Europe, and Asia. During the past year approximately 60% of the debt issuance was in the U.S. and 40% was international with Europe showing very strong demand the last two years.

Stockholders' equity is the second largest source of cash capital. At November 30, 2004, stockholders' equity provided approximately $15 billion or 19% of the firm's cash capital sources.

In the Lehman Brothers approach to cash capital, remaining sources of cash capital amounting to approximately $5 billion to $6 billion include the undrawn portion of unsecured and secured committed facilities with a remaining life greater than one year, including both bilateral bank structures and syndicated committed facilities. The holding company unsecured committed working capital facility generally represents $1.5 billion of the total with the committed secured facilities representing the balance. Inclusion of such committed secured and unsecured facilities as cash capital by Lehman is different from the traditional view that cash capital consists of equity plus long-term debt with a maturity greater than one year. The secured and unsecured bilateral bank structures are committed. In addition to the bilateral bank structures, the two syndicated committed facilities are included in cash capital and are drawn from time to time. The two syndicated, committed unsecured facilities consist of a $1.5 billion facility through April 2007 at the holding company and a $1.0 billion multi-currency facility at Lehman Brothers Bankhaus AG expiring on April 26, 2008.

Core deposit liabilities at the firm's banking institutions, Lehman Brothers Bank, FSB and Lehman Brothers Bankhaus AG, provided an additional $10 billion or 13% of cash capital. The regulated bank entities operate in a deposit-protected environment and are able to source low-cost funds that are generally insulated form a firm specific or market liquidity event. These are reliable funding sources for the mortgage products and selected loan assets that they fund.

Cash capital is used to fund long term funding requirements. Lehman's cash capital funding requirements include less liquid or illiquid assets such as fixed assets and goodwill, less liquid inventory, unencumbered inventory that is not in the liquidity pool irrespective of the collateral quality, secured funding "haircuts" (the difference between the market value of the available inventory and the pledge value, the value of cash advanced by counterparties against that inventory), operational cash deposited at banks, and liquid investments held to fund certain projected cash outflows. These liquid investments are managed as part of the liquidity pool.

Illiquid assets such as fixed assets and goodwill are fully funded by cash capital. Less liquid inventory positions are also completely funded if it is determined that the position would be illiquid in a stress liquidity event. For example, corporate loans and commercial mortgages are fundable on a secured basis in a normal liquidity environment, but both asset classes are funded with cash capital because the funding is not considered reliable in a stress liquidity environment. This reliable fundability assessment in a stress environment, which is performed by Treasury, is done by asset class and by geographical region in determining cash capital requirements.

Unencumbered inventory, irrespective of collateral quality, that is outside of the restricted subsidiaries is cash capitalized unless it is held as a part of the liquidity pool. The firm conservatively assumes that this unencumbered inventory is unfundable on a secured basis, presumably due to operational inefficiencies. Since this unencumbered inventory is currently not part of a secured funding transaction in normal times, the firm does not assume that it could improve operational efficiently in a stress event and use this unencumbered inventory as a source of funding. Therefore, cash capital is required to provide funding for these unencumbered assets outside of the liquidity pool. The unencumbered assets in the liquidity pool are not 100% cash capitalized.

Cash capital is required to fund operational cash. Cash at banks required to conduct the business operations of the firm. This operational cash deposited at banks for is not included in the cash balances in the liquidity pool.

Cash capital is required to fund the excess of regulatory capital requirements over the "unregulated" cash capital requirements of the businesses.

Liquid investments held to fund certain projected cash flows or prefunding used to mitigate contingent liquidity risk are funded with cash capital. These liquid investments are managed as a part of the liquidity pool.

RELIABLE SECURED FUNDING CAPACITY

Secured funding represents the majority of the funding for the firm. Since the majority of the balance sheet of Lehman Brothers, like other securities firms, is liquid, most of the funding is done on a secured basis, primarily in the deep, liquid and well established triparty repo market. Secured funding is seen as safer and more reliable than unsecured funding because of the intrinsic value of the collateral pledged and of the conservative haircuts used by market participants. Additionally, the triparty repo market adds another layer of safety from a counterparty's perspective as the firm's collateral is held by a third party bank (JP MorganChase) and is valued by the third party bank.

Management has adopted what they believe is a conservative approach to secured funding by depending on it only to the extent that it is deemed reliable in all market environments. A detailed assessment is regularly performed of secured funding capacity by asset class and by counterparty to determine how much is reliable in a stressed liquidity environment. Reliable secured funding capacity usually is set at a significant discount to normal funding capacity. Inventory that is less liquid and not deemed reliable in stress market conditions, such as high yield loans and commercial mortgages, is funded entirely with cash capital. Any short term funding that might exist for these asset classes in a normal market environment is not considered to be reliable.

In a secured funding stress liquidity event, the liquidity risks are primarily haircut widening and loss of secured funding capacity. These two risks are not additive. If some counterparties require wider haircuts to fund collateral, the firm can redirect collateral that used to be funded with those counterparts that stopped funding Lehman to other counterparts that continue to fund the firm. Some counterparts do not widen haircuts in a liquidity stress event. Instead, they may withdraw either from funding certain classes of less liquid assets, such as corporate bonds or commercial mortgages, or from providing secured funding to the firm if they are uncomfortable with the specific firm name. Highly liquid asset classes, including U.S. Treasuries, are unlikely to be impacted.

To mitigate the primary liquidity risks of haircut widening and loss of secured funding capacity, the firm has adopted what management believes is a conservative approach to secured funding by depending on it only to the extent it is deemed reliable in all market environments. The firm seeks to ascertain the trading line that the counterpart would be willing to extend to Lehman during a liquidity event. The Creditor Relations Group of the firm's Global Treasury Department conducts regular detailed reliability assessments of the firm's secured funding capacity by asset class and by counterparty to determine how much is reliable in a stressed liquidity environment. The assessments, which are mostly qualitative in nature, seek to ascertain the depth and breadth of the relationship between Lehman and the counterpart, whether the counterpart is comfortable with the asset class, meaning that the counterpart is willing to take possession of the assets if necessary, and the trading line that the counterpart would be willing to extend during a liquidity stress event. The reliable secured funding capacity as measured for each asset class is equal to the sum of the trading lines of each reliable counterpart for that asset class plus the amount of evergreen funding structures in place for that asset class. Evergreen funding structures frequently are thirteen month facilities which at twelve months of remaining life automatically extend back to thirteen month, unless the lender explicitly refuses the extension in which case the facility rolls down over twelve months. Some evergreen extendible structures have similar terms with longer durations. Reliable secured funding capacity usually is set at a significant discount to normal funding capacity.

Global Treasury has established the Reliable Secured Funding Model (RSFM) for mitigating the liquidity risk of secured funding. The RSFM operates under the following modeling assumptions. The balance sheet does not have to be reduced in size for liquidity reasons in a stress event, although it may be reduced for other risk reasons. The first three months of a secured liquidity event are the most critical and have to be carefully modeled. Past the three months, it is assumed that the market returns to "normal", as in 1998, or that the market permanently adjusts to the new conditions. The model conservatively assesses the stressed haircut level and quantatively measures the funding requirements if haircuts widen to the stressed levels and includes the short term funding requirement of the firm.

Stressed haircuts are estimated based on discussions with market participants, both inside and outside of the firm. In most cases the stressed haircuts are significantly wider than normal haircuts, for example 12% vs. 5% for index equities.

The firm is implementing thorough revisions to the model in 2005. The revisions primarily focus on the loss of secured funding capacity and seek to complement what is essentially a qualitative process by a more quantitative assessment. These are discussed further under "Planned Enhancements" later in this report.

CONTINGENCY FUNDING PLAN

Lehman has developed and regularly updates a Contingency Funding Plan ("CFP") or Funding Action Plan in the firm's terminology, which represents a detailed action plan to manage a stress liquidity event, including a communication plan for creditors, investors and clients. The CFP projects potential funds erosion in a crisis situation, and forces involvement in analysis and decision-making by senior managers who under normal conditions would delegate those responsibilities. While the main focus of the plan is to provide tools to manage and generate liquidity, it also highlights the importance of communication, both internally and externally, and the ability of the firm to quickly mobilize resources and information to optimize reaction to a crisis. The plan provides guidance on addressing various potential contingencies by clearly defining what actions need to be carried out, who is responsible for these actions, and what outcome should be expected.

The contingency plan considers two types of liquidity stress events; a firm-specific event, where there are no issues with overall market liquidity, and a broader market-wide event, which affects not just Lehman but the entire market.

In a firm-specific event, the firm assumes that there is no access to the unsecured funding market for a full year with full reliance on the liquidity pool being available to the holding company and its unrestricted subsidiaries to continue to fund the balance sheet. Minimizing refinancing risk in the debt portfolio by limiting maturity and investor concentration is the principal liquidity risk mitigants in these circumstances.

In a market liquidity event, in addition to the firm-specific pressure, Lehman assumes that counterparties to whom the firm has extended liquidity facilities draw on these facilities. To mitigate the effect of a market liquidity event, the firm has developed access to additional liquidity sources beyond the liquidity pool at Holdings. These sources include unutilized funding capacity in bank subsidiaries, LBB and LBBAG, and unutilized capacity in bilateral bank facilities.

GOVERNANCE

Corporate Governance of Liquidity and Funding for the Firm

Governance of liquidity and funding is an integral part of the overall governance framework of the firm. Governance around liquidity and funding is affected at three levels: (1) the Board of Directors, (2) senior management and firm-wide committees, and (3) Global Treasury.

The Board of Directors reviews the annual capital plan and approves the dividend and stock repurchase policies. The Board of Directors are updated on liquidity and funding by the Chief Administrative Officer and the Chief Financial Officer as a part of their regular briefings. The Finance Committee of the Board also reviews risk, including liquidity risk, in January and at its mid-year meeting. The Board has delegated most liquidity and funding decisions to the firm's senior management and to several high-level governance committees. The delegation of most liquidity and funding decisions to the firm's senior management is generally consistent with the approach of other securities firms.

The Finance Committee of the Board, chaired by Dr. Henry Kaufman, reviews and advises the Board on the financial policies and practices of the firm, including liquidity, capital, balance sheet and risk. Its responsibilities also include annually recommending to the Board the firm's dividend policy and stock repurchase plan. Lehman's Finance Committee of the Board is not as closely involved in many liquidity and funding decisions as the finance committees at many other firms. Much of this responsibility has been delegated to senior management, the Management Finance Committee, and Global Treasury.

Senior management and the Management Finance Committee, a completely separate committee from the Finance Committee of the Board, are responsible for developing, implementing and enforcing the liquidity, funding, and capital policies. The CFO is chairman of the Management Finance Committee and its members include the Treasurer, Financial Controller, Capital Markets Controller and Co-heads of International Finance, as well as other senior employees across the global finance department including Treasury, Product Control and Financial Control. This committee is responsible for policies relating to cash capital, liquidity, and balance sheet size as well as capital allocations to business units. The responsibilities also include establishment and enforcement of capital and funding limits which ensure that the firm is not exposed to undue funding or liquidity risk. The Management Finance Committee responsibilities include oversight and implementation of policies including capital and funding limits setting.

In addition to the Management Finance Committee's policies responsibilities, it reviews the firm's liquidity, funding, and capital positions weekly. Among the weekly tasks of the Management Finance Committee is reviewing the 90-day forward and one year forward liquidity position for the holding company and each of the broker dealers including explanations for week over week changes. The cash capital positions of all businesses are reviewed along with explanations of changes and forecasted usage. The investment performance of the liquidity pool is reviewed. Lehman debt issuance and spreads are reviewed. The financial position and pipeline for the Lehman Brothers Bank and Lehman Brothers Bankhaus are reviewed. Balance sheet targets for month-end and quarter-end are reviewed by division among the other responsibilities performed by this committee.

Global Treasury administers the development and implementation of the Funding Framework and advises senior management on major capital funding decisions. Treasury has the delegated authority to implement capital funding decisions other than "major funding decisions", but as a practical matter the firm states that capital funding decisions are reviewed with senior management of the firm regardless of size before going forward. Global Treasury senior management performs the analysis and recommends limits at the firm and division levels to the management finance committee as a part of the annual budgeting process after consulting with various members of senior management, including the business units.

Additionally, certain liquidity and funding issues are also handled elsewhere including the Asset Liability Committee (ALCO) which coordinates the firm's strategy around secured funding, debt issuance and liquidity management. The committee meets weekly and is comprised of members from Treasury, the Fixed Income and Equities funding desk and selected product controllers.

There is a weekly meeting between Treasury and the Syndicate Desk that focuses on recent trends in the debt markets and issuance opportunities for Treasury in the U.S., Europe and Asia. More frequent meetings are held near issuance times to refine details of the issuance such as syndication strategy and issuance amount. The Board of Directors has authorized the Global Treasurer and the Global Head of the Asset Liability Management function within Global Treasury to issue debt. In practice, all recommendations are reviewed with the CAO and CFO for their approval.

There is also a daily morning conference call providing one of the main forums within Treasury to discuss liquidity and funding issues. Every day, the liquidity of the firm and its major broker dealers is reviewed, and changes in liquidity numbers are explained. Investment decisions for the liquidity pool and recent market trends are discussed.

Governance Relating to Capital Planning Policies

Capital planning policies governance relates to the following:

- Balance sheet and capital plan allocation
- Common stock dividend and stock repurchase
- Capital infusion and distribution
- Guarantees

Capital planning is a critical aspect of the firm's overall management. This responsibility is administered by the Financial Planning & Analysis function within Treasury at Lehman Brothers. During the fourth quarter of each year, the Business Planning and Analysis Group in Finance leads the global budget process for the firm, in which Treasury and the Financial Planning & Analysis are actively involved. Treasury's role in the budget process is to recommend a comprehensive capital plan with policies on common stock dividend, stock repurchase, balance sheet management, and debt issuance.

The goal of the capital plan is to balance the business units' requests for financial resources against the firm's capital availability, while addressing competing factors such as a need to support business growth, maintain a track record of steady and sizeable percentage increases in dividends, offset compensation-related equity award dilution and maintain a capital structure consistent with a credit ratings profile of at least a strong "A".

Treasury maintains the capital plan on a continuous basis and monitors all of the variables which affect the plan. Any material changes are brought to the attention of the Global Treasurer and CFO for review and approval.

Additionally, the Firm's funding, capital and balance sheet positions are reviewed weekly by the Management Finance Committee, which is responsible for developing, implementing and enforcing these financial policies.

Funding Framework Governance

The governance of the Funding Framework, which is discussed above under "Adequacy of Liquidity", is a key part of the liquidity and funding governance. As stated above, the Funding Framework is defined by the four pillars of liquidity management. The models, policies, procedures, and plans that are associated with the funding framework have been documented, widely distributed, approved by senior finance management and are reported against on a monthly, weekly, and, in some cases, daily basis. This set of policies and models has already pre-determined much of the decision making process around liquidity risk management. Therefore, the governance is required to be both simplified and transparent. Among the decision making that takes place based upon the results of these models is when to raise funds and how to invest funds.

This framework and these policies and models define a set of tangible and quantifiable policies for managing liquidity and funding risk. Any proposed changes to these policies are reviewed by the global treasurer, presented to the management finance committee, communicated to relevant front office businesses and, depending on the materiality, signed off by the global CFO.

BALANCE SHEET MANAGEMENT

Balance sheet management is integrated with the budget and capital plan. The budget and capital plan are presented annually to the Finance Committee of the Board of Directors. The annual budget and capital plan of the firm establish budgets for operating the business, as well as financial and risk objectives including the firm's risk appetite, capital, leverage, and balance sheet size for the upcoming year. Development of the budget takes several months with input from all functions in the firm. Execution of the budget is management's responsibility, including management and control of the balance sheet. Finance under the management of the Finance Controller, Ed Grieb, is responsible for balance sheet control and works closely with the businesses and other responsible organizational functions. Product control "owns" month end inventory balance management. They work closely with the business units which manage to leverage targets as well as asset and product limits.

The size of the balance sheet is determined primarily by the firm's risk appetite, acceptable levels of leverage, and capital, which are all established in the budgeting process, reported against and actively managed. Balance sheet growth is permitted as long as it can be justified and is within the firm's risk appetite and levels of leverage. The credit rating agencies are very concerned about leverage. Leverage is a key consideration at Lehman, and there is emphasis on management of leverage, balance sheet size, liquidity, financial strength, and improving the credit rating.

Highly Liquid Balance Sheet

Lehman Brothers maintains a highly liquid balance sheet and marks to market nearly all of its assets daily. A significant part of the firm's assets are readily funded in the secured financing markets, predominantly through repurchase agreements and securities lending.

Total assets for Lehman Brothers Holdings, Inc. were $357 billion and $364 billion at November 30, 2004 and February 28, 2005 respectively. The firm's Fixed Income Division is the largest user of balance sheet assets and has the largest funding needs on both a secured and unsecured basis.

Balance Sheet Targets

Balance sheet targets are developed for the firm and its divisions each year as a part of the capital plan. The balance sheet capacity is a function of target leverage ratios, equity, business opportunities and risk appetite. During the capital planning and budgeting process, the divisions submit to Treasury their requests for monthly balance sheet levels based on their revenue budget. Treasury recommends divisional targets. The balance sheet targets are reviewed and approved by the CFO and the Management Finance Committee. Once approved, the divisional CFO is responsible for allocating the monthly balance sheet limits on a regional and product level.

Leverage and the leverage ratio are key metrics used to manage the balance sheet for the total firm and for divisions, including the fixed income and equities divisions. The leverage ratios are considered critical to balance sheet management because one of the firm's primary goals is to improve its credit ratings. Having a capital structure and leverage ratios consistent with ratings agency requirements is critical to improving the firm's credit ratings. While Lehman has made some progress recently, their credit ratings are still not as high as those of Merrill Lynch, Goldman Sachs, and Morgan Stanley. Yet, much of their debt trades with similar spreads in the secondary markets. Lehman Brothers has been working persistently with the credit rating agencies to get upgraded.

The leverage ratio has been receiving special focus in the budgeting and management process. Management also believes that the leverage ratio is an excellent tool for managing the balance sheet and assuring profitable operations. Assets, which are in the numerator, are not allowed to increase unless equity, which is in the denominator, also increases.

Less Liquid Assets

The liquidity of the balance sheet is closely analyzed as part of the analysis of cash capital requirements. The firm's definition of illiquid assets not only includes non trading assets such as fixed assets, goodwill, deferred tax assets, and private equity investments, but also assets that lack liquidity in a stressed event and are 100% cash capitalized by Lehman Brothers. These include trading assets such as commercial whole loans and mortgages as well as both rated and not rated corporate loans. Derivatives, haircuts on liquid assets and certain other assets including unencumbered assets left in the box are 100% cash capitalized by the firm, which is viewed as a conservative approach.

Less liquid assets at February 28, 2005 amounted to $26.6 billion. Significant categories of trading assets included commercial whole loans and mortgages of $14.4 billion, corporate loans of $5.1 billion, and derivatives of $1.8 billion. Illiquid assets, including fixed assets of $1.8 billion, goodwill of $3.3 billion, operational cash at banks of $2.1 billion and deferred tax assets of $2 billion, totaled $12.2 billion at February 28, 2005.

The amounts of illiquid and less liquid assets are monitored by Global Treasury. Increases in these assets increase the amount of cash capital required by the firm. The information is reported and reviewed weekly at the Management Finance Committee meeting.

TOTAL CAPITAL – FUNDING AND CAPITAL RESOURCES

Total capital, which is long term debt plus stockholders' equity, is a measure of financial strength because it aggregates long term funding sources. Total capital for Lehman Brothers Holdings, Inc. was $75.1 billion and $71.4 billion for the quarter ended February 28, 2005 and the year ended November 30, 2004, respectively. Total capital of $75.1 billion at February 28, 2005 was composed of $59.3 billion of long term debt and $15.8 billion of stockholders' equity. Total capital of $71.4 billion at the year end was composed of $56.5 billion of long term debt and $14.9 billion of stockholders' equity. The firm's total capital is substantially higher than the $58.0 billion at the prior year ended November 30, 2003 because of a significant increase in long term debt from $45.5 billion as well as the growth in stockholders' equity. Long term debt includes $1.0 billion of junior subordinated debt with a 49 year maturity and provisions that allow the firm to defer interest payments for up to 20 quarters. The firm and a leading rating agency tend to view these securities as equity capital.

In terms of unsecured funding, as of February 28, 2005, Lehman had outstanding $56.2 billion in long-term debt and $3 billion in short-term debt, including $1.7 billion in commercial paper. Lehman diversifies the sourcing for its long-term debt by issuing both fixed and floating rate securities denominated in US dollars, Euros and the Japanese Yen, all of which are generally swapped into U.S. dollar LIBOR. As of November 30, 2004, the $56 billion in outstanding long-term debt issued by Lehman fell into the following buckets:

US fixed-rate	$21 billion (37%)
US floating-rate	$15 billion (26%)
Non-US fixed-rate	$7 billion (12%)
Non-US floating-rate	$14 billion (24%)

Typically, Lehman's long-term debt issuances are sized to qualify for the Lehman Bond Index ($250 million for fixed-rate; $300 million for floating-rate). Lehman further seeks, with respect to size, timing and maturity, to minimize the impact of an issuance on the yields of its previously issued bonds. This reduces the volatility risk of the existing bondholders.

Lehman further diversifies its long-term debt issuances by offering different types of products. For example, in addition to "plain vanilla" senior notes, it issues structured notes of various types in the US, Europe and Asia. For example, in 2004, it issued $7.1 billion in structured notes across the following product types and jurisdictions:

	US	London	Asia	(Millions)
Credit Linked	$18	$385	$432	
Equity Linked	$1,488	$1,636	$992	
Interest Rate	$798	$886	$48	
Other	$80	$183	$225	

The purchasers of Lehman's structured notes tend to be different than the purchasers of its senior notes. In fact, the structured note purchasers frequently approach Lehman because they need a security with a particular type of characteristic to meet a specific need (e.g., hedging). That is, the credit spread component of the note is not the primary motivation behind the purchase. Generally, the embedded derivatives in the bonds are hedged by Lehman's trading desks.

The firm seeks to diversify the creditor base when issuing unsecured debt, preferring investors who are expected to hold the investments rather than those who would trade quickly in stress situations.

Lehman monitors the buyers of its long-term debt at issuance. Of its outstanding US debt, there were 92 investors who purchased more than $50 million at issuance. The largest purchase by an investor was $1.1 billion. Of its outstanding European issuances, there were 90 investors who purchased more than $50 million at issuance. The largest purchase by an investor was $1.2 billion.

Secured funding represents a significant part of the funding for the firm. The firm uses the Reliable Secured Funding Model ("RSFM"), which is discussed above, in managing liquidity risk relating to secured funding availability.

Lehman funds its prime broker customer lending on a secured basis by using customer collateral. This raises the risk that, in a stress event, Lehman would have to restrict its prime brokerage activities because it could not use customer collateral to re-fund an existing financing or enter into a new financing. To mitigate this risk, customer financings are funded through term transactions where the tenor of the funding transaction is at least as long as the term of the customer financing.

TOTAL FUNDING ($ in millions)

	February 28, 2005	November 30, 2004
Short-term borrowings:		
Commercial paper & short term debt	$ 3,079	$ 2,857
Securities sold under agreements to repurchase	104,951	105,956
Securities and other inventory positions sold but not yet purchased	97,209	96,281
Long-term borrowings:	59,366	56,486
Stockholders' equity:	15,754	14,920
	75,120	70,406

Note that bank customer deposits are a source of funding but are included in customer payables and are not separately disclosed by the firm.

CREDIT FACILITIES

The firm maintains two committed revolving unsecured credit facilities. First, the holding company maintains a $1.5 billion revolving credit agreement with a syndicate of banks whose term runs through April 2007. This committed credit facility is a working capital facility that is regularly drawn upon in the normal course of business and is fully drawn from time to time. The firm believes that this eliminates the signaling effects of drawing on the facility, and differentiates it from some other firms where the credit facility is a back stop facility and not drawn or seldom drawn in full. This credit facility contains covenants that require the firm to maintain a specified level of tangible net worth. There is a second multi-currency unsecured committed revolving credit facility of $1.0 billion with a syndicate of banks for Lehman Brothers Bankhaus AG, the European bank affiliate. This facility has a term of three and a half years expiring on April 26, 2008. In the firm's view, any amounts drawn on the facilities would qualify as cash capital (i.e., debt with a maturity greater than one year). The facilities do not contain provisions that would permit the lenders to cancel them if Lehman suffered a material adverse event other than requiring the firm to maintain tangible net worth of $7 billion (currently the firm has $11.6 billion) and meet all subsidiary broker-dealer capital requirements. They also contain pricing provisions under which interest on drawn amounts increases if Lehman's credit rating falls. Lehman's intent is to regularly draw down 25-30% of each facility's capacity. This mitigates the possibility that drawing on the facility would send an adverse signal to Lehman's creditors and the marketplace. Lehman intends to use the drawn amounts for general corporate purposes. Lehman believes the advantages to using the facilities include that they, (1) are cheaper than issuing long-term debt, (2) provide greater flexibility than is obtained through issuing long-term debt, and (3) strengthen Lehman's relationships with the banks involved. There were no borrowings under either credit facility at either February 28, 2005 or at November 30, 2004.

The firm also maintains several billion dollars of committed secured bilateral bank facilities, which increase the funding flexibility. The funding flexibility in these facilities is increased because they are cross currency, cross entity, and cross product facilities that are regularly used.

CREDITOR RELATIONS GROUP

Lehman's Global Treasury organization includes a group responsible for creditor relations. Heidemarie Echtermann, a managing director, heads the group and reports directly to Lehman's Global Treasurer. The group has a global staff of 18. The group's core mission is to source unsecured credit for Lehman. In the last four years, however, its mandate has expanded to "creating partnerships" with creditor banks. For example, creditor relations seeks to identify products offered by its banks that Lehman could assist in distributing. The goal is to develop lasting and mutually beneficial relationships with the banks in order to maintain access to unsecured credit and avoid a situation where a bank walks away from Lehman based on a lack of information and trust (as occurred in 1998). The creditor relations personnel stay in close contact with the bank personnel and seek to develop relationships throughout a given bank's chain of command. The group holds annual creditor meetings in which Lehman's business strategies, liquidity management, and credit and market risk policies are reviewed. Lehman's intent is to make these policies sufficiently transparent to the creditors and, thereby, instill confidence in how the firm is managed. Currently, Lehman has relationships with 55 banks of which 41% are in the US, 48% in Europe, and 10% in Asia.

PROPOSED ENHANCEMENTS

The enhancements generally fall into three categories. First, there are improvements to the Funding Framework, which offer better ways to access and mitigate the liquidity risk faced by the firm. Secondly the firm is developing new funding vehicles, which are more reliable and less expensive than the existing sources. Third, the firm is seeking to improve its operational effectiveness of secured funding.

The major enhancements for 2005 relating to liquidity and funding include a new framework to access and mitigate liquidity risk for secured funding. The Reliable Secured Funding Model, which sets the rules around secured funding, will be updated and expanded. The current model was built primarily around the Lehman-specific events that occurred in the Fall of 1998. The primary revision focuses on the loss of secured funding capacity and attempts to compliment what is essentially a qualitative process by a more quantitative assessment of how secured funding availability could diminish. The loss of secured funding would be a major event that may have far reaching implications, many of which would be outside of the firm's control. Yet, management wants to prepare as best they can for such an occurrence.

The policy and procedures on structured notes is being reviewed with the objective of more effectively accessing the funding benefit of structured notes.

New and expanded banking opportunities are being analyzed in several areas including industrial loan corporations, commercial banks, and a new conduit structure to mitigate contingent liquidity risk for high grade unfunded loan commitments. The firm is working on an on-balance sheet conduit structure that would provide prefunding to mitigate liquidity risk of the unfunded loan commitment portfolio. The conduit would be fronted by a highly rated European bank and would be able to issue structured liquidity notes even in the case of a Lehman specific liquidity event. The industrial loan corporations are subject to the same regulations as state-chartered commercial banks but do not require that the parent company be regulated as a Bank Holding Company by the Federal Reserve Board. The main benefit of a commercial bank would be to provide an additional reliable funding source that is less expensive and would have access to the discount window of the Federal Reserve, which could be useful in a major liquidity event.

There is interest in improving secured funding operational effectiveness. That is the focus of the "Triventure" initiative, which is a joint venture between Treasury and the Fixed Income and Equities repo desks. This is a firm wide effort also involving the front office, information technology and operations. Lehman funds an average of $450 billion of collateral on a secured basis each day and recognizes that even small improvements can result in risk reduction and increased efficiencies. The firm has found that the coordinated effort during the last two years to improve the overall funding process has yielded a series of initiatives to make improvements, some of which are in progress. Continued improvements are being pursued. They include strengthening the reliability of secured funding by structuring transactions to support certain businesses and related transactions while optimizing customer and triparty providers synchronization, real time intraday stock record, one global funding platform, leverage equities platform to fund certain fixed assets reducing box positions, boxed positions analysis to reduce the amount of unintentionally boxed collateral that is funded by cash capital, cross entity clearance consolidation, stock loan depot consolidation.

STOCK REPURCHASE PROGRAM

The determination of the appropriate amount of equity is affected by a number of factors, including the amount of "risk equity" the businesses require, rating agency considerations, balance sheet leverage and the dilutive effect of equity-based employee incentive programs. Equity requirements are constantly changing, and Lehman actively monitors its requirements.

The principal purposes of Lehman's stock repurchase program were historically to manage the company's equity capital relative to the growth of its business and risk requirements, and to offset the dilutive effect of equity-based employee incentive programs. The repurchase program is implemented through regular open-market purchases as well as through the acquisition of mature shares from employees upon stock option exercises and the withholding of shares for required tax withholding upon option exercises and conversion of restricted stock units to freely-tradable common stock. During 2004, Lehman repurchased approximately 29.0 million shares of its common stock at an aggregate cost of approximately $2.3 billion, or $78.12 per share, as authorized by the Board of Director. During the first quarter of 2005, Lehman repurchased approximately 8.6 million shares of its common stock at an aggregate cost of approximately $771 million, or $89.15 per share, as authorized by the Board of Directors.

Stock repurchases are undertaken to offset the dilutive effect of equity-based employee incentive programs on earnings per share over time. When evaluating the net funding requirements of stock repurchases, the firm considers the cash outflows net of the proceeds received from employees upon the exercise of stock options, the incremental tax benefits from the issuance of stock-based awards and the value of employee services received—as represented by the amortization of deferred stock compensation—that will be settled by delivering shares of common stock instead of by paying cash.

For 2005, Lehman's Board of Directors has authorized the repurchase of up to approximately 65 million shares of common stock principally to offset dilution due to employee stock plans. Of this amount, approximately 35 million shares were authorized for repurchase in 2005, and up to an additional 30 million shares were authorized for repurchase in fiscal 2005, subject to market conditions, to meet 2006 requirements.

CREDIT RATINGS

Like other companies in the securities industry, Lehman relies on external sources to finance a significant portion of day today operations. The cost and availability of unsecured financing generally are dependent on short term and long term credit ratings. Factors that may be significant to the determination of the firm's credit ratings or otherwise affect the ability to raise short term or long term financing include earnings trends and volatility, profit margins, cash liquidity and liquidity management, capital structure, risk levels and risk management, geographic and business diversification, and the firm's relative position in the markets in which it operates. A deterioration in any of the above factors or a combination of these factors may lead rating agencies to downgrade the credit ratings, which would increase the cost of certain types of unsecured financings and triggering additional collateral requirements in derivative contracts and other secured funding arrangements. In addition, debt ratings can affect certain capital market revenues, particularly in businesses where longer term counterparty performance is critical, such as OTC derivative transactions, including credit derivatives and interest rate swaps. At February 28, 2005, the firm would have been required to post additional collateral pursuant to derivative contracts and other secured funding arrangements of $228 million in the event of a one notch downgrade of the senior debt and $610 million in the event of a two notch downgrade.

Lehman Brothers Holdings, Inc. (Holdings) and Lehman Brothers, Inc. (LBI) short term and long term credit ratings as of February 28, 2005 were as follows:

	Holdings		LBI	
	Short-term	Long-term	Short-term	Long-term
Dominion Bond Rating Svc	R-1(middle)	A(high)	R-1(middle)	A(high)
Fitch Ratings	F-1	A+	F-1	A
Moody's Investor Service	P-1	A1	P-1	A1
Standard and Poor's	A-1	A	A-1	A

V. CONCLUSIONS

The review of the liquidity risk management functions of Lehman Brothers found no material deficiencies. There are a number of planned enhancements, which are described above and were discussed with the firm. The staff will review these with the firm as part of its ongoing supervisory program.

The Lehman Brothers approach to the liquidity pool and cash capital differs from the traditional approach that has been seen in the other securities firms. The liquidity pool as viewed by Lehman Brothers includes the undrawn portion of the holding company's $1.5 billion committed working capital credit facility whereas the traditional approach does not include such facilities in the liquidity pool. The SEC staff view is that such facilities are distinct from cash and unencumbered liquid securities that can be readily hypothecated. Regarding cash capital, the Lehman Brothers approach is different from that used by other firms in that committed unsecured and secured facilities with remaining terms of over one year are included as a source of cash capital at the holding company in addition to equity and long-term debt with a remaining term greater than one year. While the staff recognizes that committed secured and unsecured facilities may be viewed as a source of funding in managing liquidity risk, it does not agree with changing the traditional definition of cash capital to include such facilities. For purposes of analysis, the staff will adjust the liquidity pool and cash capital numbers accordingly.

Lehman Brothers currently has adequate liquidity and sufficient capital to fund its current business in the staff's opinion.

Overall, with respect to liquidity and funding risk management, Lehman Brothers has an adequate liquidity and funding risk management function to become a CSE, and accordingly, it is recommended that the application by Lehman Brothers to become a CSE, as it pertains to the liquidity and funding risk management function, be approved.